Skadden

Skadden, Arps, Slate, Meagher & Flom LLP
& Affiliates

*If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.*

**Jonathan L. Frank**
New York
212.735.3386
jonathan.frank@skadden.com

**Mark A. McDermott**
New York
212.735.2290
mark.mcdermott@skadden.com

**George A. Zimmerman**
New York
212.735.2047
george.zimmerman@skadden.com

**Yosef Ibrahimi**
New York
212.735.2562
yosef.ibrahimi@skadden.com

* * *

*This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.*

Four Times Square, New York, NY 10036
Telephone: 212.735.3000

WWW.SKADDEN.COM

# Supreme Court Holds That Bankruptcy Courts May Report and Recommend on *Stern* Claims

On June 9, 2014, the United States Supreme Court issued its highly anticipated ruling in *Executive Benefits Insurance Agency v. Arkison (In re Bellingham Insurance Agency, Inc.)*.[1] The *Bellingham* decision clarifies one of the significant, open issues raised three years ago by the Court's controversial decision in *Stern v. Marshall*.[2] In *Stern*, the Court held that the constitution precluded non-Article III judges, such as bankruptcy judges, from making final determinations of certain matters set forth as "core" matters under the bankruptcy jurisdiction provisions of Title 28 of the United States Code. The decision left open the question, among others, of whether such "core" matters could be heard in bankruptcy court at all, because Title 28 did not otherwise provide for consideration of statutory "core" matters, upon certain of which bankruptcy judges could not constitutionally render final judgments. In *Bellingham*, the Supreme Court answered this unresolved question, unanimously ruling that bankruptcy judges may treat such claims, which it called "*Stern* claims," as noncore matters, and issue proposed findings of fact and conclusions of law subject to *de novo* review and the entry of a final judgment by the district court. The Court expressly reserved decision on, among other things, whether parties may expressly or impliedly consent to a bankruptcy judge hearing and finally determining a *Stern* claim.

As background, in *Stern*, the Supreme Court had ruled that a bankruptcy judge could not constitutionally enter a final ruling on a debtor's state law counterclaim against a litigant that filed a proof of claim against the debtor's bankruptcy estate unless the debtor's counterclaim "stems from the bankruptcy itself" or adjudication of the debtor's counterclaim "necessarily" would resolve the creditor's proof of claim. Because such state law counterclaims are statutorily designated as "core" matters, prior to *Stern*, practitioners considered such disputes to be "core" matters properly within the domain of the bankruptcy courts for determination and final decision. *Stern* immediately changed this landscape. Its ruling resulted in numerous and varied decisions and extensive commentary concerning its application. The unclear boundaries of the *Stern* ruling called into question not only bankruptcy judges' authority to hear and finally determine a myriad of statutorily "core" matters over which their authority had been assumed, but also whether parties could consent to the bankruptcy court's authority to issue final judgments on a *Stern* claim.

State law-based fraudulent transfer actions are one significant class of such matters, with bankruptcy litigants and courts having understood for decades that such matters are the virtually exclusive province of bankruptcy judges. *Stern* upended this long-held understanding but did not specify what remained of the bankruptcy court's authority in its wake. Eighteen months after *Stern*, the *Bellingham* case came before the United States Court of Appeals for the Ninth Circuit to consider this question. The Ninth Circuit held that bankruptcy judges are in fact precluded from entering final judgments in

1 573 U.S. ___ (2014), No. 12-1200

2 564 U.S. ___ (2011), 131 S.Ct. 2594

fraudulent transfer actions, despite the fact that Title 28 classifies such actions as "core" proceedings that bankruptcy judges may finally adjudicate.[3] Nevertheless, that court affirmed the judgment because it found the defendant had impliedly consented to the bankruptcy court's final adjudication of the fraudulent transfer claim by failing to challenge the bankruptcy court's authority to issue a final order until the matter was on appeal to the Ninth Circuit.

In *Bellingham*, the Supreme Court affirmed the Ninth Circuit's decision. The Supreme Court explained that the law that created the core/noncore distinction (the Bankruptcy Amendments and Federal Judgeship Act of 1984) contained a severability clause that provided for the remaining provisions of the law to be given full effect even if a specific portion of the law was invalid. The Court reasoned that although *Stern* claims were core matters under 28 U.S.C. § 157(b), that provision was invalid as applied to *Stern* claims, and therefore, under the severability clause, the *Stern* claims must be treated as noncore claims. Accordingly, the Court held that bankruptcy judges may enter proposed findings of fact and conclusions of law on *Stern* claims, and that the district court shall review the proposed findings of fact and conclusions of law *de novo* before entering final judgment. The Court declined to affirm the Ninth Circuit's ruling that the defendant had consented to the bankruptcy court's final adjudication of the *Stern* claim and affirmed on the ground that any potential error resulting from the bankruptcy court's summary judgment order was cured by the district court's *de novo* review and entry of its own valid final judgment.

While offering clarity on the process for adjudicating *Stern* claims, the Supreme Court left unanswered certain questions raised by *Stern*. Specifically, the Court expressly reserved judgment on whether: (i) the defendant in *Bellingham* had consented to the bankruptcy court's final adjudication of the *Stern* claims at issue and (ii) Article III of the Constitution permits the parties to a dispute to expressly or impliedly consent to a bankruptcy court issuing final judgment on a *Stern* claim. In addition, although the Ninth Circuit found that the fraudulent conveyance claims at issue in *Bellingham* were *Stern* claims, the Supreme Court did not affirm that portion of the decision below, and simply assumed without deciding on the merits that the fraudulent conveyance claims at issue were *Stern* claims. Without firm guidance on precisely which statutory core claims are *Stern* claims, parties to bankruptcy litigation may continue to litigate over the proper treatment of specific *Stern* claims. Moreover, it remains unclear whether parties may consent to bankruptcy courts finally deciding *Stern* claims in the same way that parties may consent to the bankruptcy courts issuing final judgments in noncore matters. It also remains unclear whether such consent to bankruptcy courts finally deciding *Stern* claims may be implied or must be express.

3 702 F.3d 553 (9th Cir. 2012)